1st East and Central Africa Islamic Banking Conference

Introduction to Islamic Insurance (Takaful)

29 April 2009

Morgan Stanley

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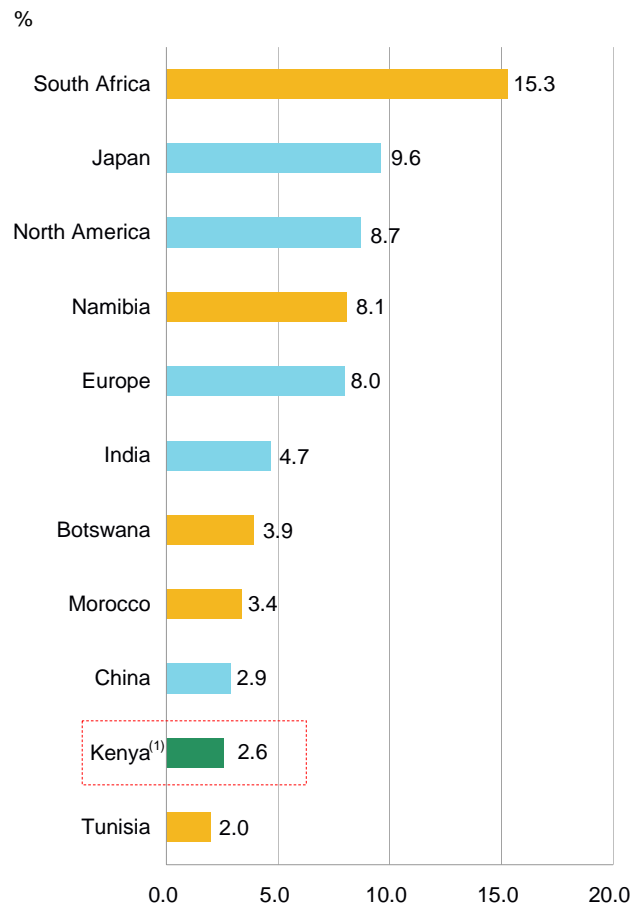
Section 1

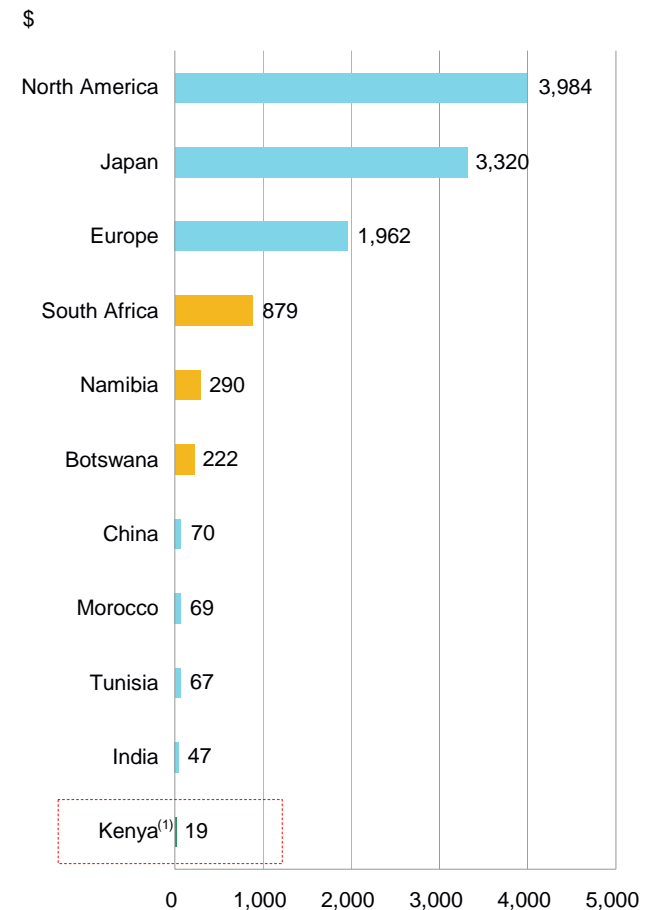
Context of Islamic Insurance in Kenya

CONTEXT OF ISLAMIC INSURANCE IN KENYA

Insurance Penetration and Density Comparison

- Low insurance penetration and density in Kenya suggest strong growth potential

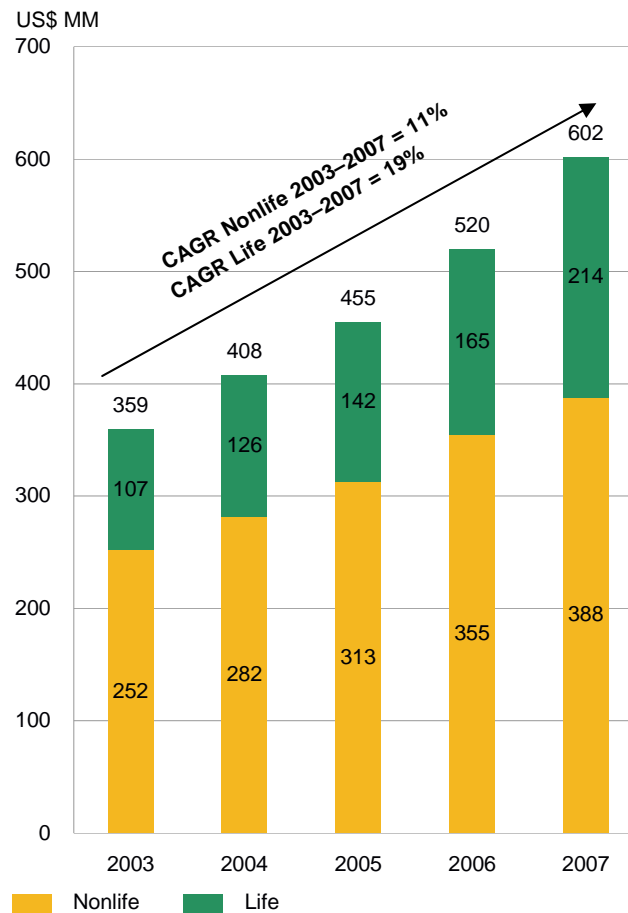
Insurance Penetration in 2007

Source Swiss Re—World Insurance 2007, Islamic Capital Partners (ICP)

Insurance Density in 2007

Source Swiss Re—World Insurance 2007, Islamic Capital Partners (ICP)

Notes
1. Data from Kenya Insurance Regulatory Authority

Insurance Premiums and General Insurance Breakdown

- General insurance more predominant in Kenya with a market share of 64% in 2007

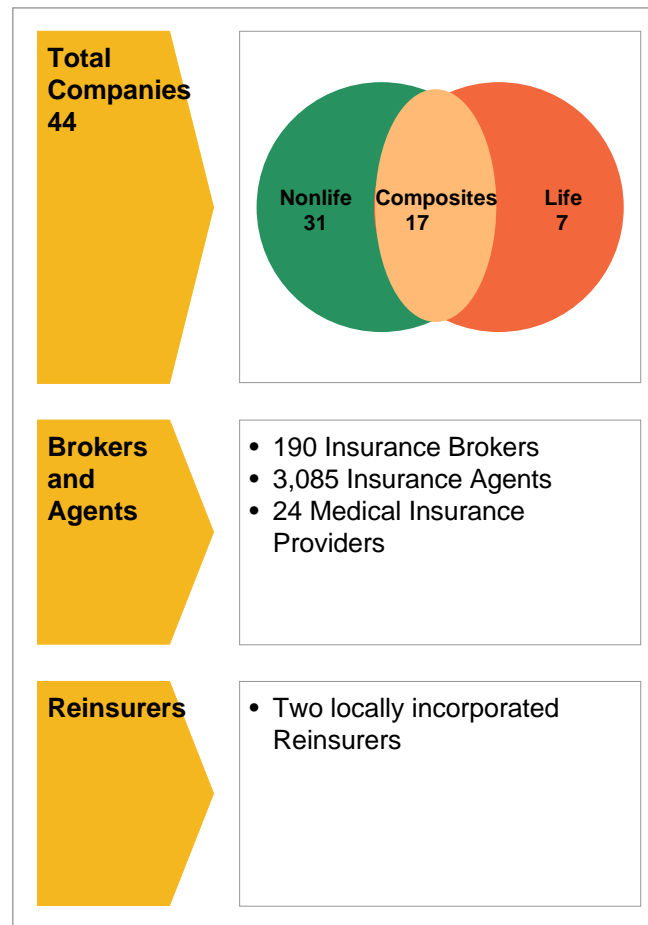
Gross Insurance Premiums

Source Kenya Insurance Regulatory Authority, ICP Analysis

General Insurance Breakdown in 2007

Source Kenya Insurance Regulatory Authority, ICP Analysis

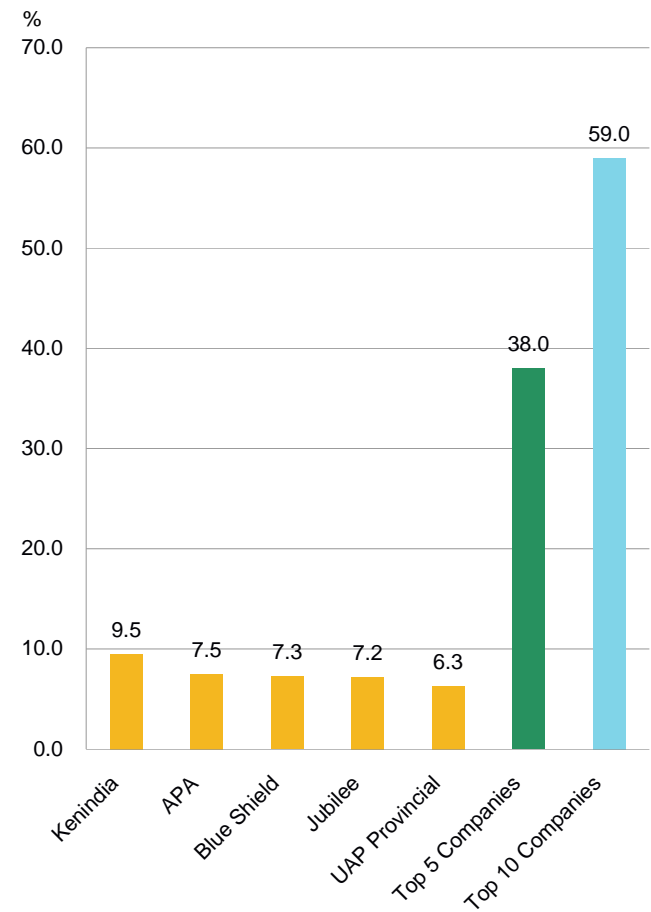
Insurance Companies—Classification and Competitive Landscape

- Large number of players with low capitalisation facing tough competition

Insurance Industry Market Structure in 2007

Source Kenyan Insurance Regulatory Authority, ICP

General Insurance Cos Market Share in 2007 (1)

Source Kenyan Insurance Regulatory Authority, ICP

Notes
1. Based on Gross Premiums

Performance Analysis

- Fragmented market with tough competition

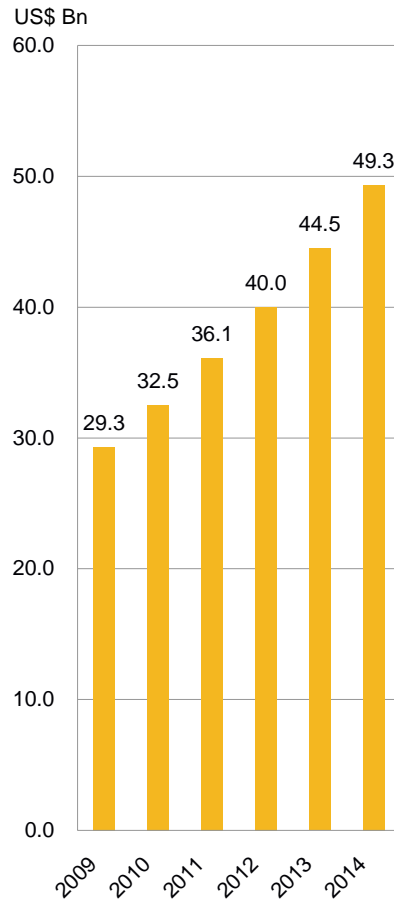
RoE of Top 5 Kenyan Insurance Companies
2007

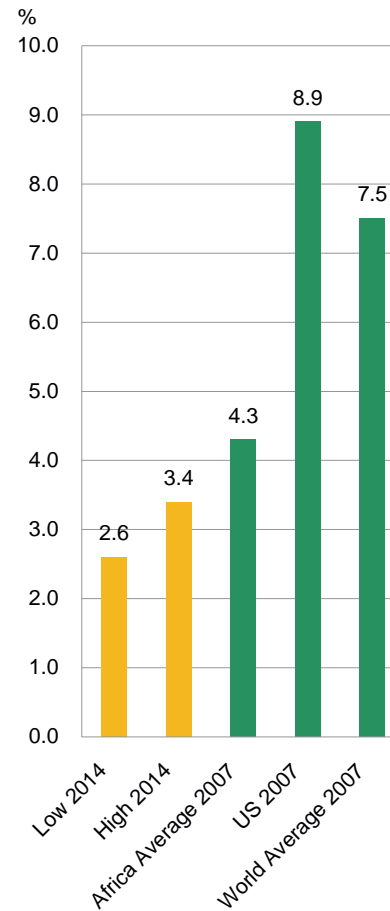
General Insurance Companies	Total No.of Cos. In the Segment	No. of Cos. Making Underwriting Profits	% of Cos. Making Profits
Motor—Commercial	36	23	64
Motor—Private	35	7	20
Fire—Domestic	35	27	77
Fire—Industrial	35	23	66
Engineering	35	25	71
Personal Accident	37	23	62
Theft	35	23	66
Workmen's Comp.	35	16	46
Other Liabilities	35	23	66
Marine	35	21	60
Aviation	6	4	67
Miscellaneous	35	25	71
Total	**38**	**22**	**58**

Source Kenya Insurance Regulatory Authority, ICP Analysis

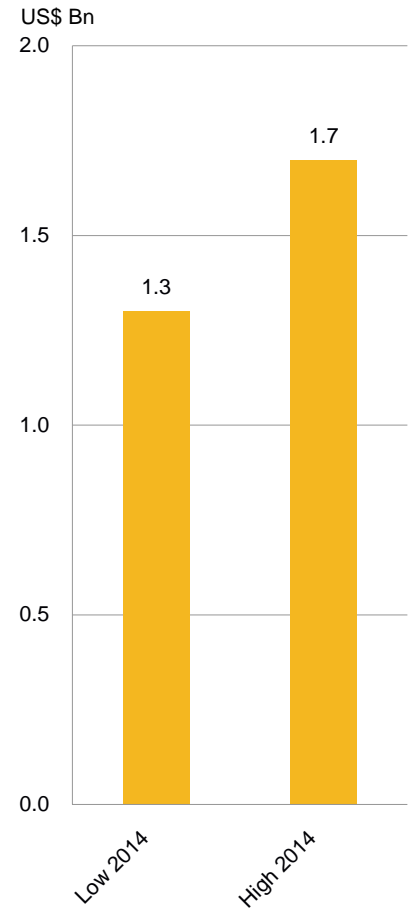
Projected Gross Insurance Premiums

- Gross premiums projected between US$1.3 Bn–US$1.7 Bn in 2014 based on GDP forecast of US$49.3 Bn and insurance penetration of 2.6% and 3.4%

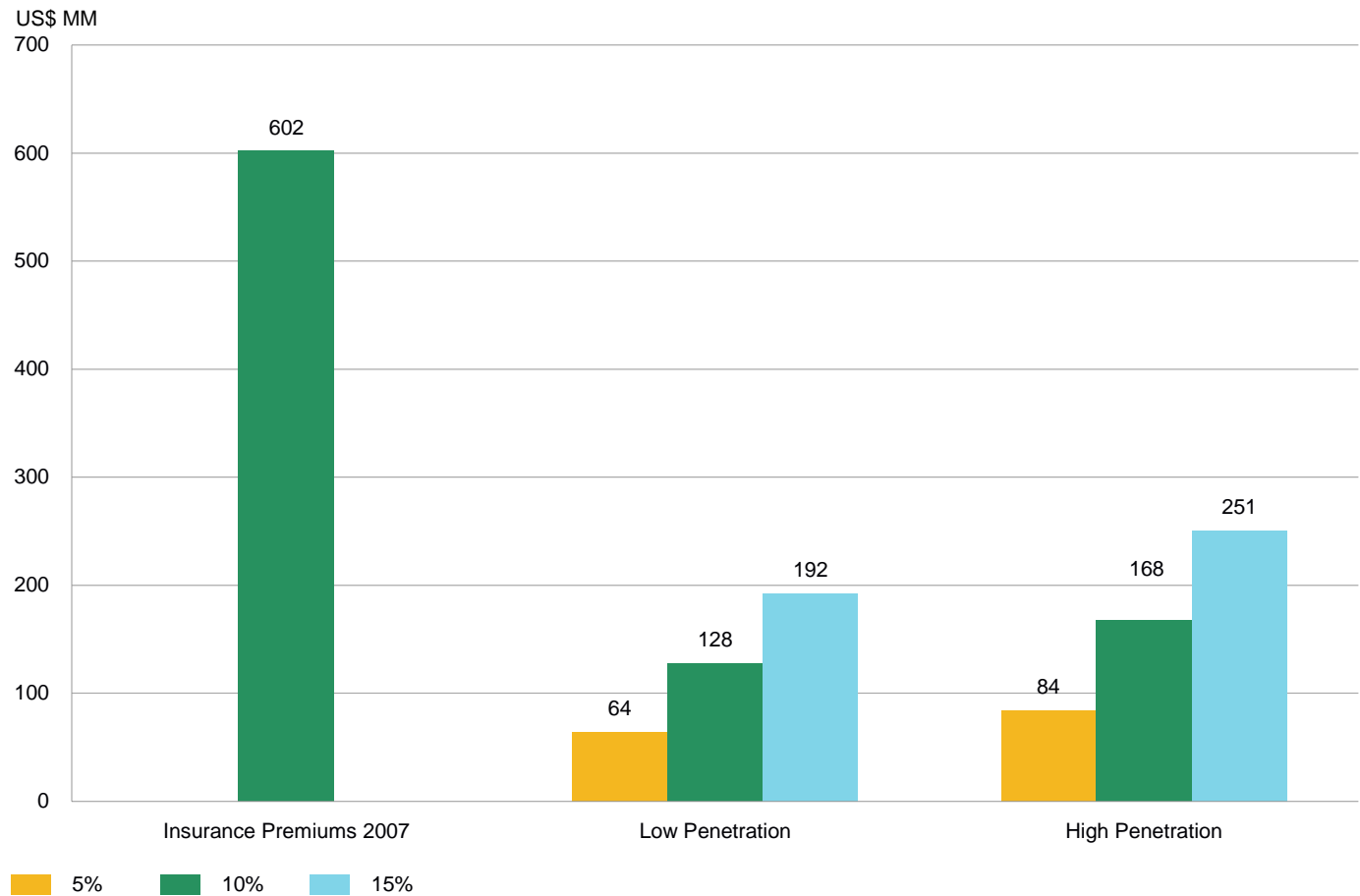
Forecasted Nominal GDP

Source Global Insight, ICP Analysis

Gross Premiums as a % of GDP

Source Global Insight, ICP Analysis

Gross Premiums

Source ICP Analysis

Potential Takaful Size by 2014

- Takaful industry in Kenya could be potentially $250 MM in 2014

Projected Share of Takaful Premiums in 2014

Source Kenya Insurance Regulatory Authority, ICP Analysis

Summary

- Industry competitive with 44 insurance players, yet insurance penetration and density very low at 2.6% and $19 respectively
- General insurance dominates the market with a market share of 64%
- Only a handful companies generating growth with profitability, most operators either dormant, generalists or serving captive markets
- Companies making significant underwriting losses in private motor and workmen's compensation
- Industry RoE averaging at 9.2%
- Low capitalisation of companies resulting in a lack of innovative products and tough competition
- Islamic Insurance in Kenya could potentially be $250 MM by 2014

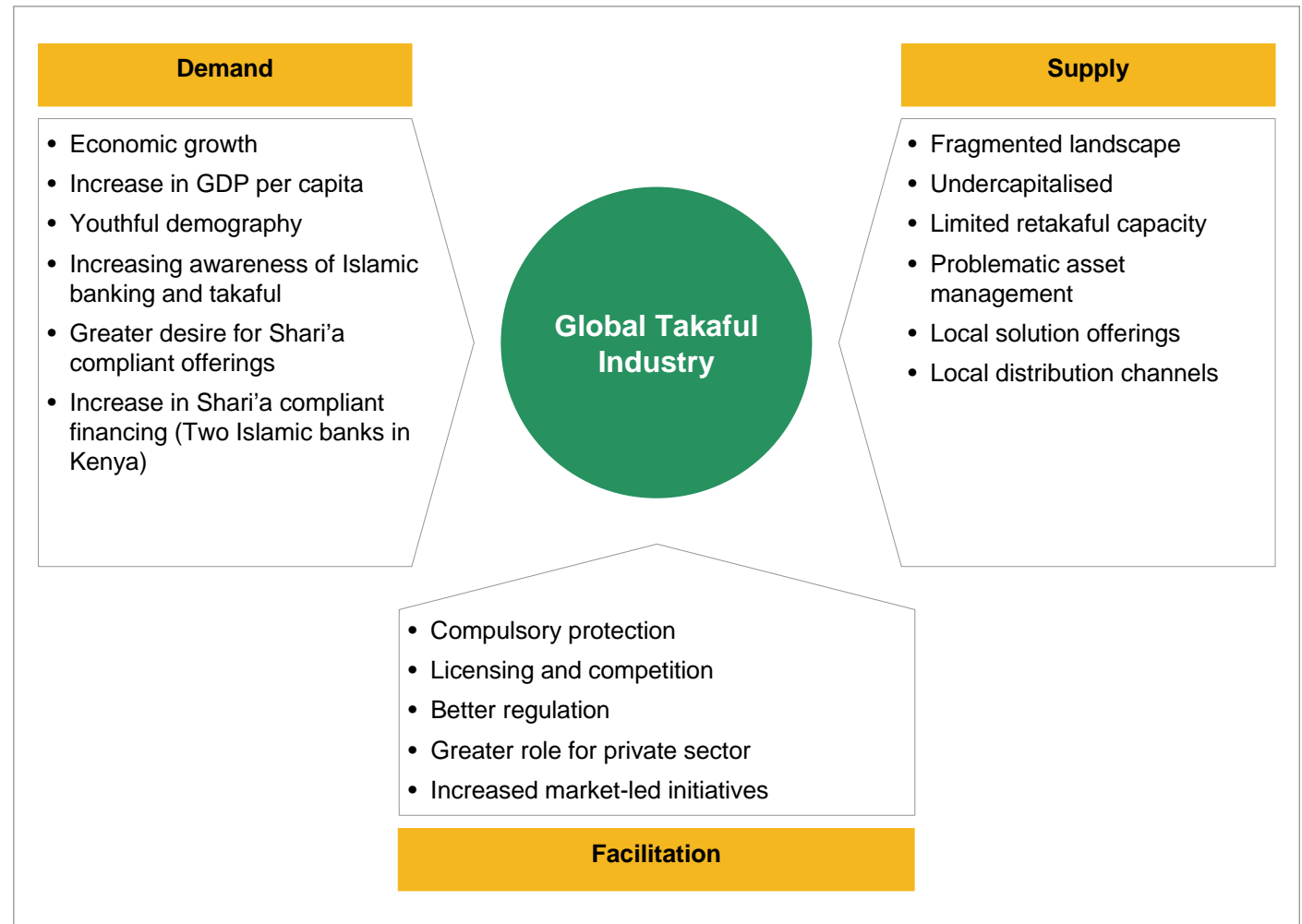
Section 2

Islamic Insurance: An Introduction

Overview

- Takaful is a US$2 Bn industry (2006) growing by at least 20%–30% p.a. (against global insurance premium of $3.7 Tn)
- These premiums are projected to increase to at least US$10 Bn by 2015
- More than 250 takaful companies globally
- Takaful concept is similar to conventional cooperative insurance and involves increased emphasis on transparency and corporate governance
- Takaful model is double compliant: incorporates industry best practices in underwriting, customer service, reserving, etc., while being in conformity with Shari'a principles
- Industry is emerging as an important source of attracting foreign direct investment
- Existence of Islamic banking and takaful industry is an important catalyst for infrastructure and developmental projects in many markets

Current Industry Dynamics

- The Takaful industry is poised for significant growth as demand increases and industry enablers are further aligned

Takaful Concept Explained

Conventional Insurance (Nonmutual)	• Company accepts premiums from the insured at a level which it anticipates will cover claims and result in a profit • This process of anticipation is akin to *maysir* (speculation)
	• Insured pays premiums to the Company in exchange for indemnity against risks that may not occur • This process of ambiguity is akin to *gharar* (uncertainty)
	• Company engages in investments that derive their income from interest and/or prohibited industries • This process is akin to *riba* (usury) and/or relates to *haram* (prohibited) activities
Takaful	• Based on principal of *Ta'awun* (mutual assistance) that is *Tabarru* (voluntarily) provided • Similar to conventional cooperative insurance whereby participants pool their funds together to insure one another

Takaful Concept Explained (cont'd)

Five Key Elements

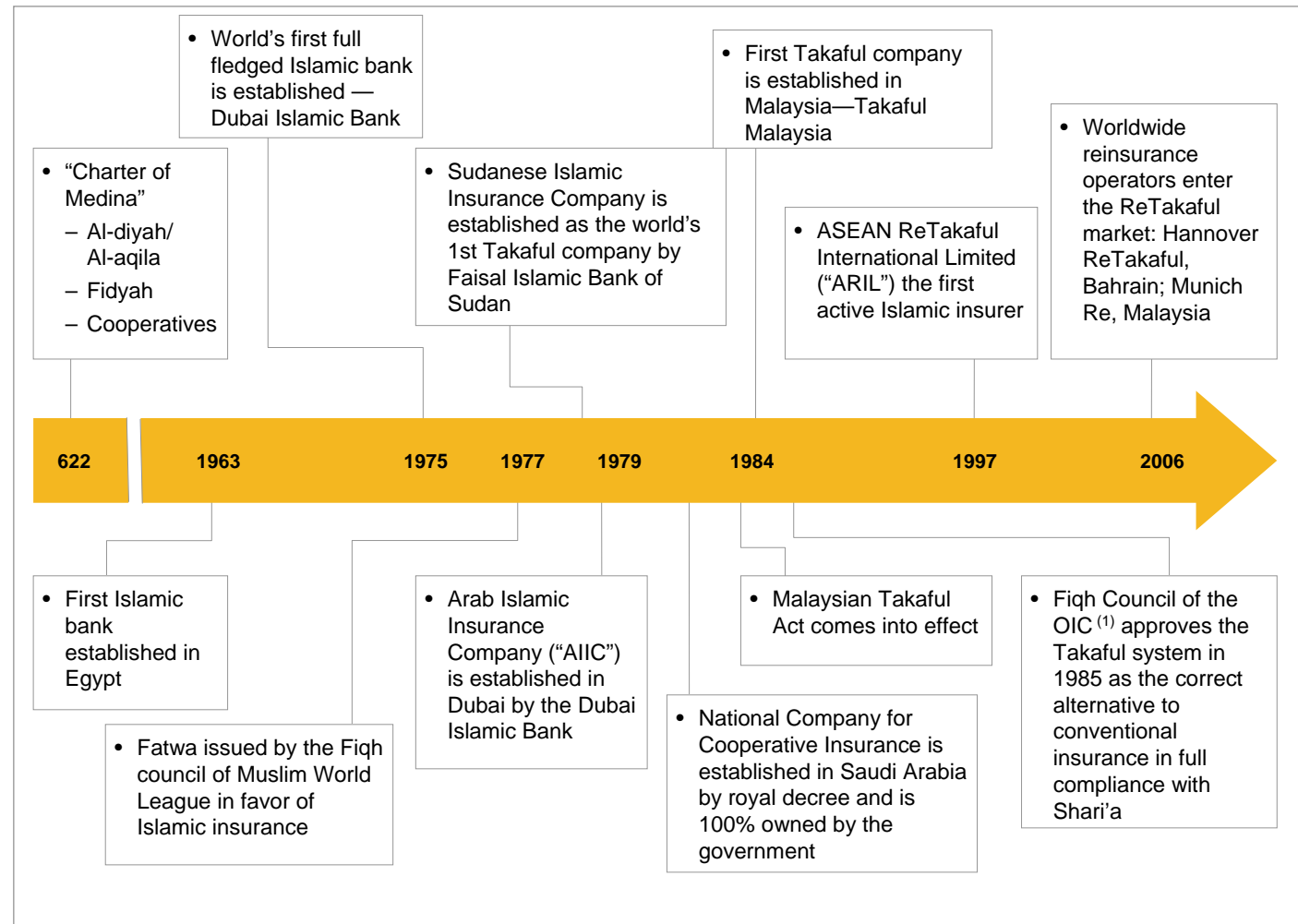
- **Mutual Guarantee**—Basic objective of Takaful is to pay a defined loss from a defined fund. Loss is borne by a fund created by the donations of policyholders. Liability is spread amongst the policyholders and all losses divided between them
- **Ownership of Fund**—Donating their contributions to the Takaful fund, policyholders are owners of the fund and entitled to its profits
- **Elimination of Uncertainty**—Donations, causing transfer of ownership to the fund, are voluntary to mutually help in the case of a policyholder's loss without any predetermined monetary benefit
- **Management of Takaful Fund**—Management is by operator who, depending on the adopted model, utilises either (or a combination) of two Shari'a compliant contracts
- **Investment Condition**—All investments must be Shari'a compliant, which prohibits investment in *haram* industries and requires use of instruments that are free of *riba*

Comparison of Takaful and Conventional Insurance

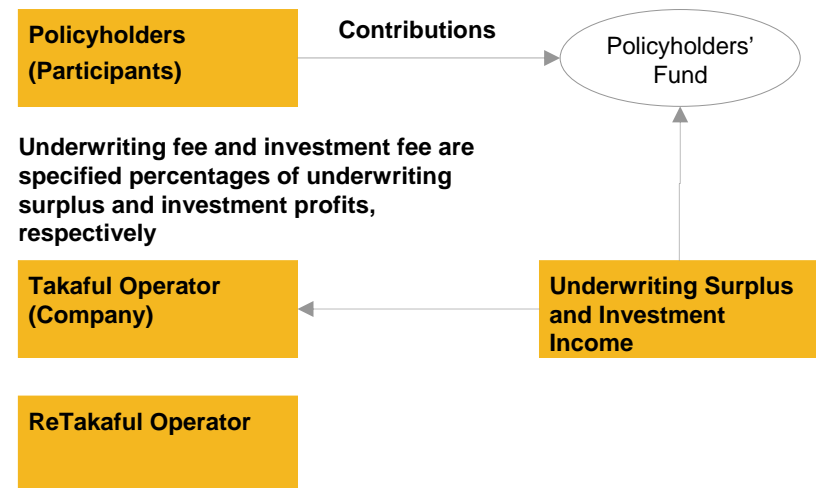
- Takaful can be considered a Shari'a compliant form of conventional cooperative insurance

	Takaful	Cooperative Insurance	Proprietary Insurance
Contracts Utilised	Donation and mutual contract	Mutual contract	Exchange contract
Company Responsibility	Pay claims with underwriting fund and interest free loan in case of shortfall	Pay claims with underwriting funds	Pay claims from underwriting funds and shareholder equity
Participant's Responsibility	Pay contributions	Pay contributions	Pay premiums
Capital Utilised	Participant's funds	Participating capital	Share capital
Investment Considerations	Shari'a compliant	No restrictions except prudential	No restrictions except prudential

- Contemporary execution of Takaful has existed for less than three decades

Timeline in Perspective

Source Factiva, Company Websites, IICP

Notes
1. The Organisation for the Islamic Conference

Takaful Business Model…More Transparency

Section 3

Global Takaful Markets

Low Insurance Penetration in Important Growth Regions

- Insurance penetration is visibly lower in developing countries and those with sizeable Muslim population

Premiums as % of Nominal GDP in 2006

Source Swiss Re Sigma No. 4 (2007), E&Y Analysis, ICP

Premiums per Capita in 2006

US$

North America	Western Europe	Japan and NI Asia (1)
1,486	1,746	3,033

Source Swiss Re Sigma No. 4 (2007), E&Y Analysis, ICP

Notes
1. Newly industrialised Asian economies

Low Insurance Penetration Can Be Attributed to a Number of Factors

Takaful…A Viable Alternative

Religious	• Shari'a sensitivities led to injunctions against conventional insurance. Severely restricting demand, particularly for personal and life products
Cultural	• Extended family system historically acted as the primary source of financial support to the dependent population, particularly the elderly
Regulatory and Fiscal	• Insurance sector historically lacked regulation (and in some instances been closed) discouraging insurance operators from writing business and subsequently leading to reduced customer awareness
	• Lack of fiscal incentives aimed at encouraging savings, together with a high level of state support, have annulled the creation of corporate pension plans and reduced the demand for private sector annuity and savings products
Demographic	• Legislation aimed at increasing private sector savings is a response to ageing populations where retirement is outpacing taxable workforce expansion. Countries with a youthful population and rapidly expanding workforce do not yet face these problems

GLOBAL TAKAFUL MARKETS

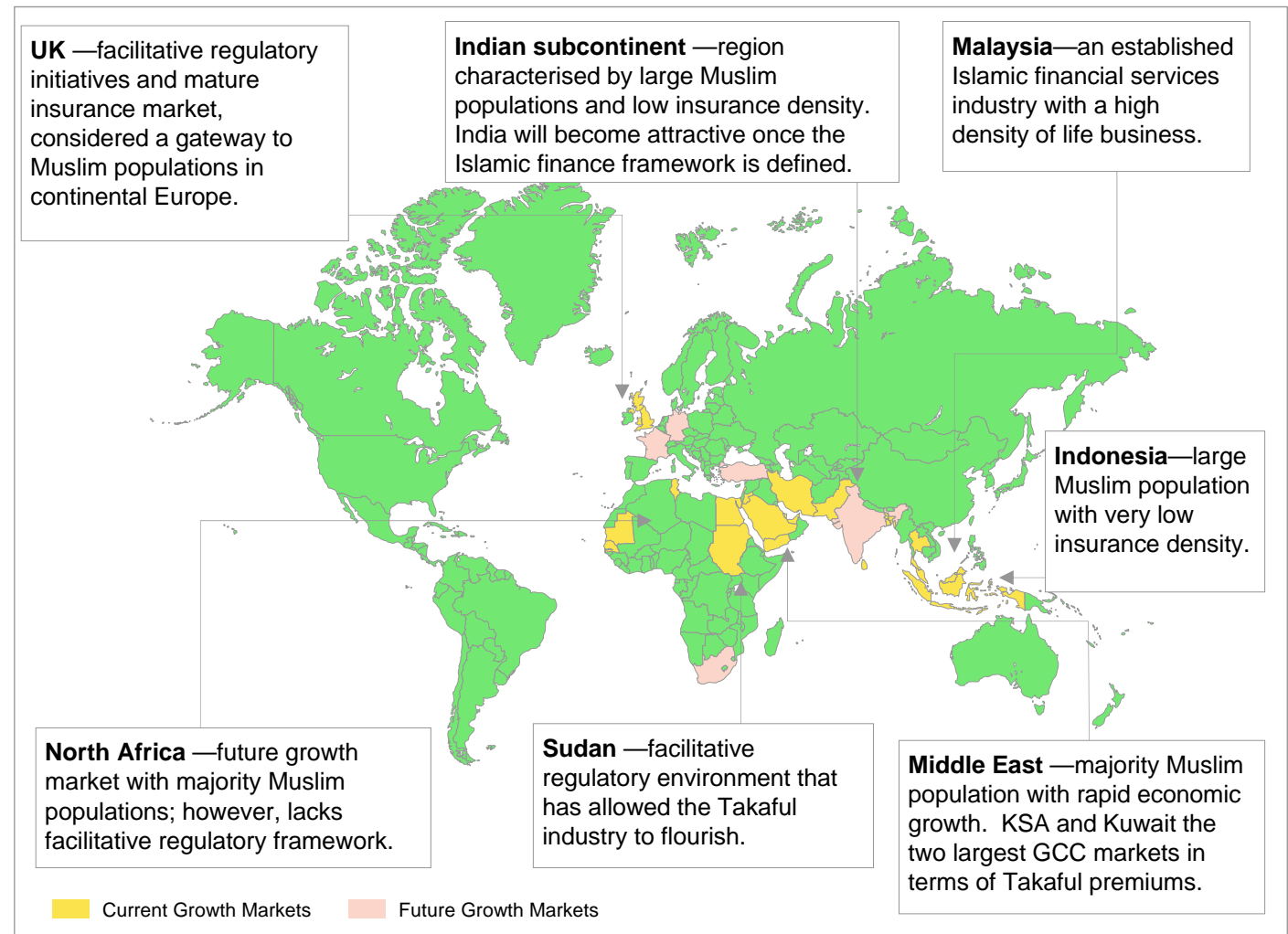
US$2 Bn Global Takaful Industry …

And Growing by 20%–30% p.a.

Source Takaful Re Limited and Middle East Insurance Review (2008), E&Y Analysis, ICP

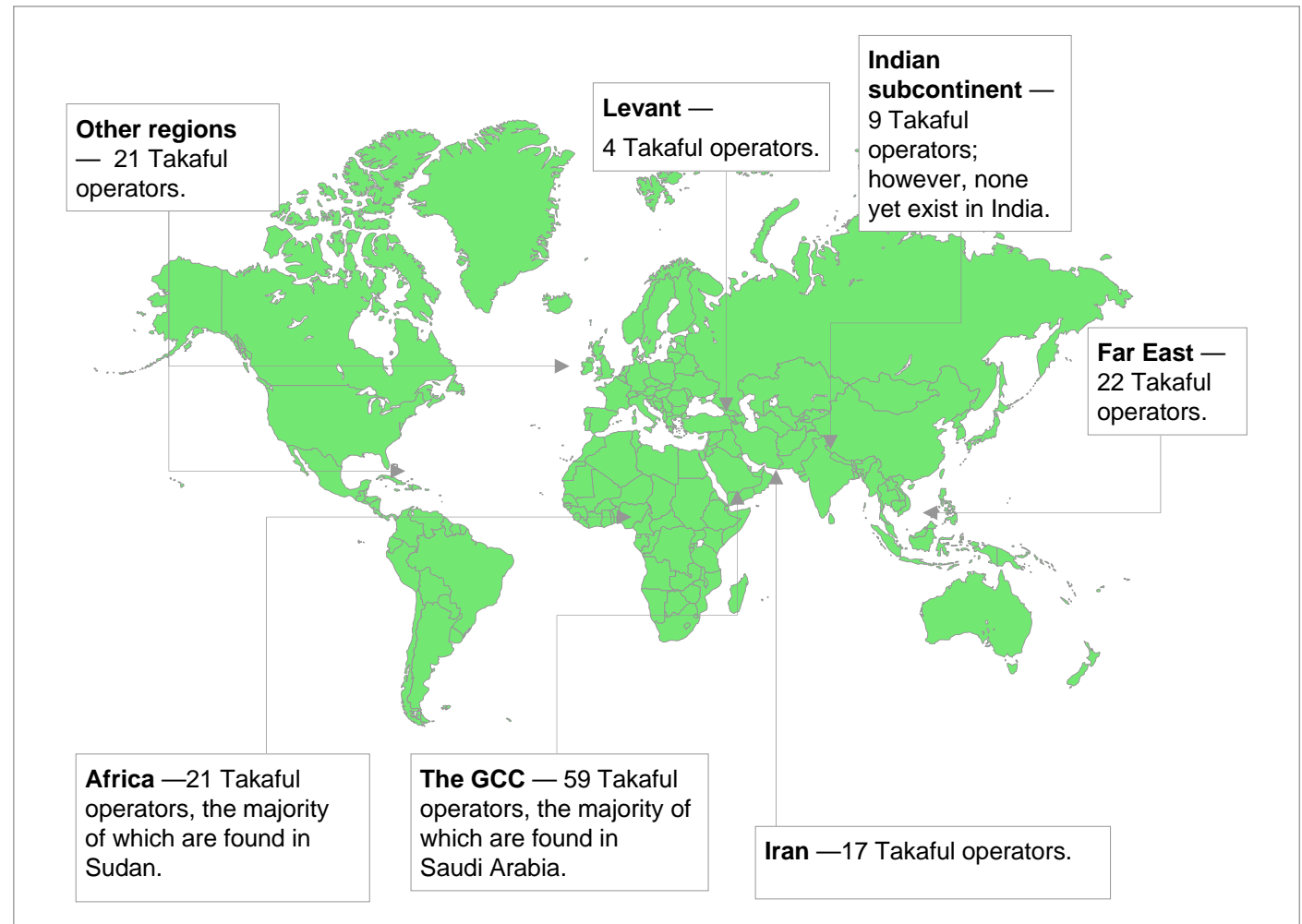
Notes
1. Estimated
2. [Forecasted]

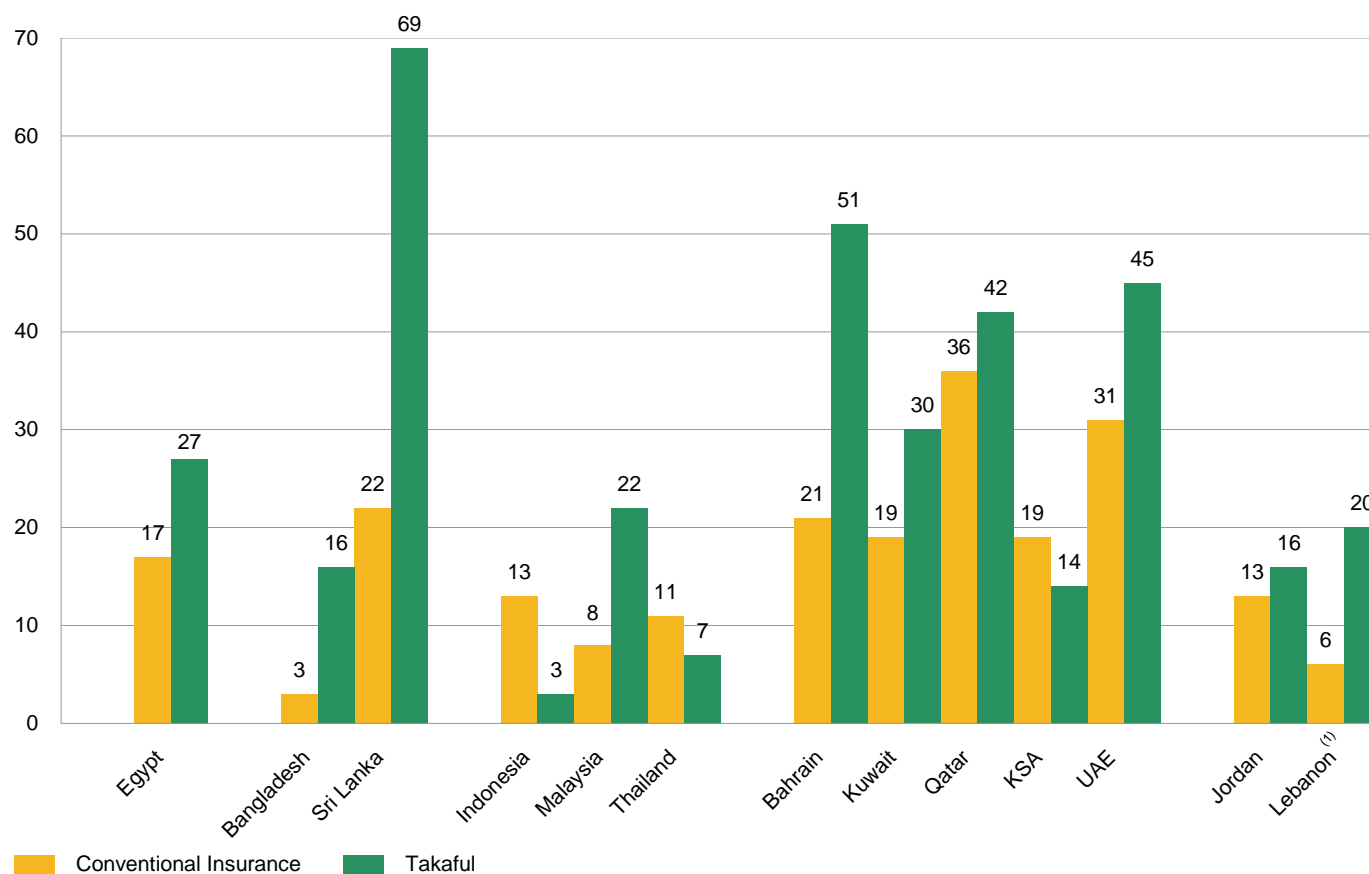
Global Takaful Markets

- The takaful industry is rapidly expanding beyond its home markets

Source Takaful Re Limited and Middle East Insurance Review (2008), Factiva, E&Y Analysis, ICP

GLOBAL TAKAFUL MARKETS

Some 250 Takaful Operators Already Operational (133 in 2006)

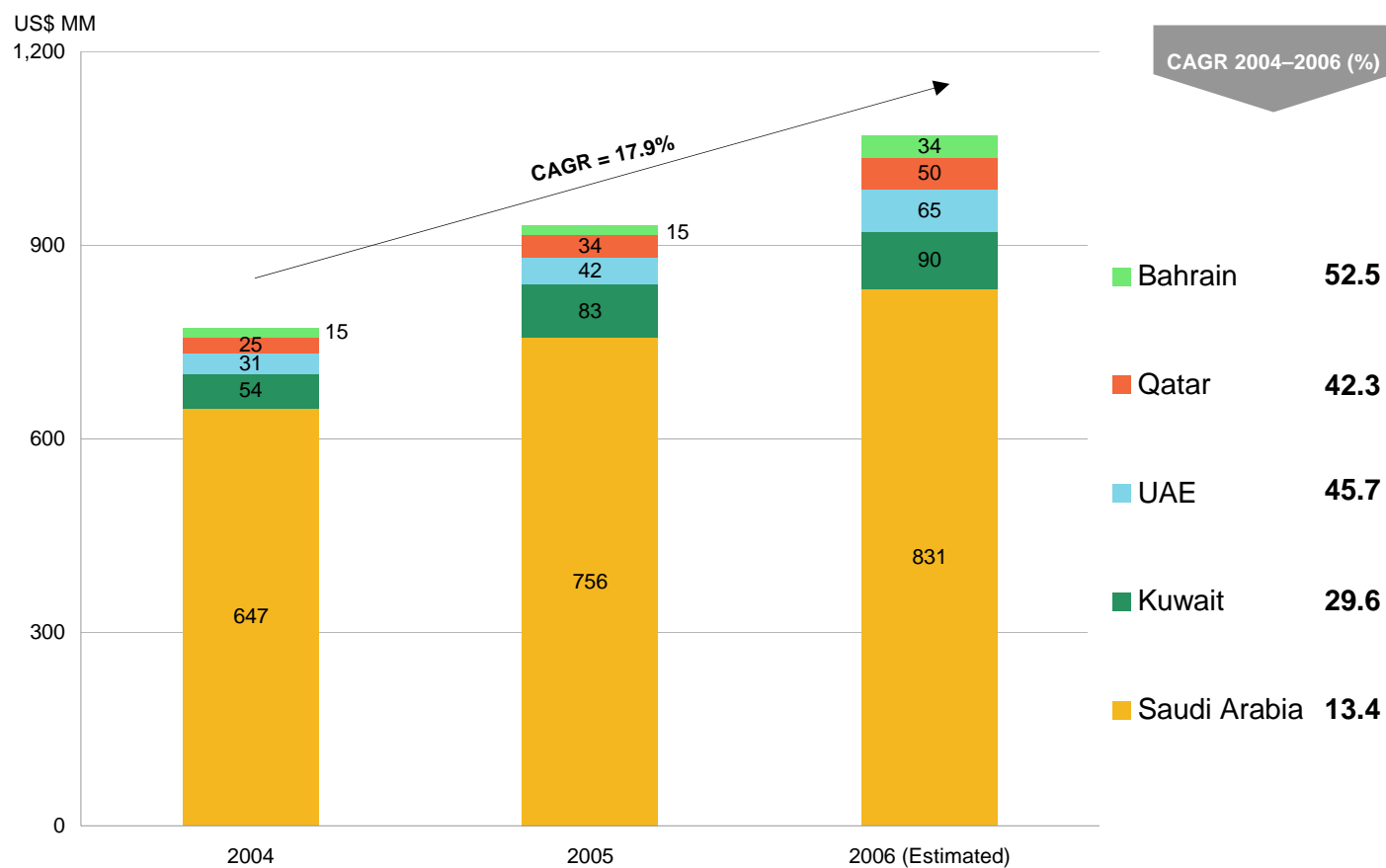
- Tremendous growth in number of takaful operators with global names like Swiss Re, AIG, etc., entering the market

Source Takaful Re Limited and Middle East Insurance Review (2008), E&Y Analysis, ICP

Growth in Takaful Far Outpaces Conventional Segment

Source Swiss Re—Sigma No. 4 (2007) and Business Monitor for International Insurance, Takaful Re Limited and Middle East Insurance Review (2008) for Takaful, E&Y Analysis, ICP

Notes
1. Bahrain's insurance sector growth and Lebanon's Takaful sector growth are both for 2005–2006 only

Capital Surplus GCC Region Is Leading This Growth Momentum

- GCC is the single largest takaful market with $1 Bn in premiums (2006);
- GCC is also an active takaful investor in other regions

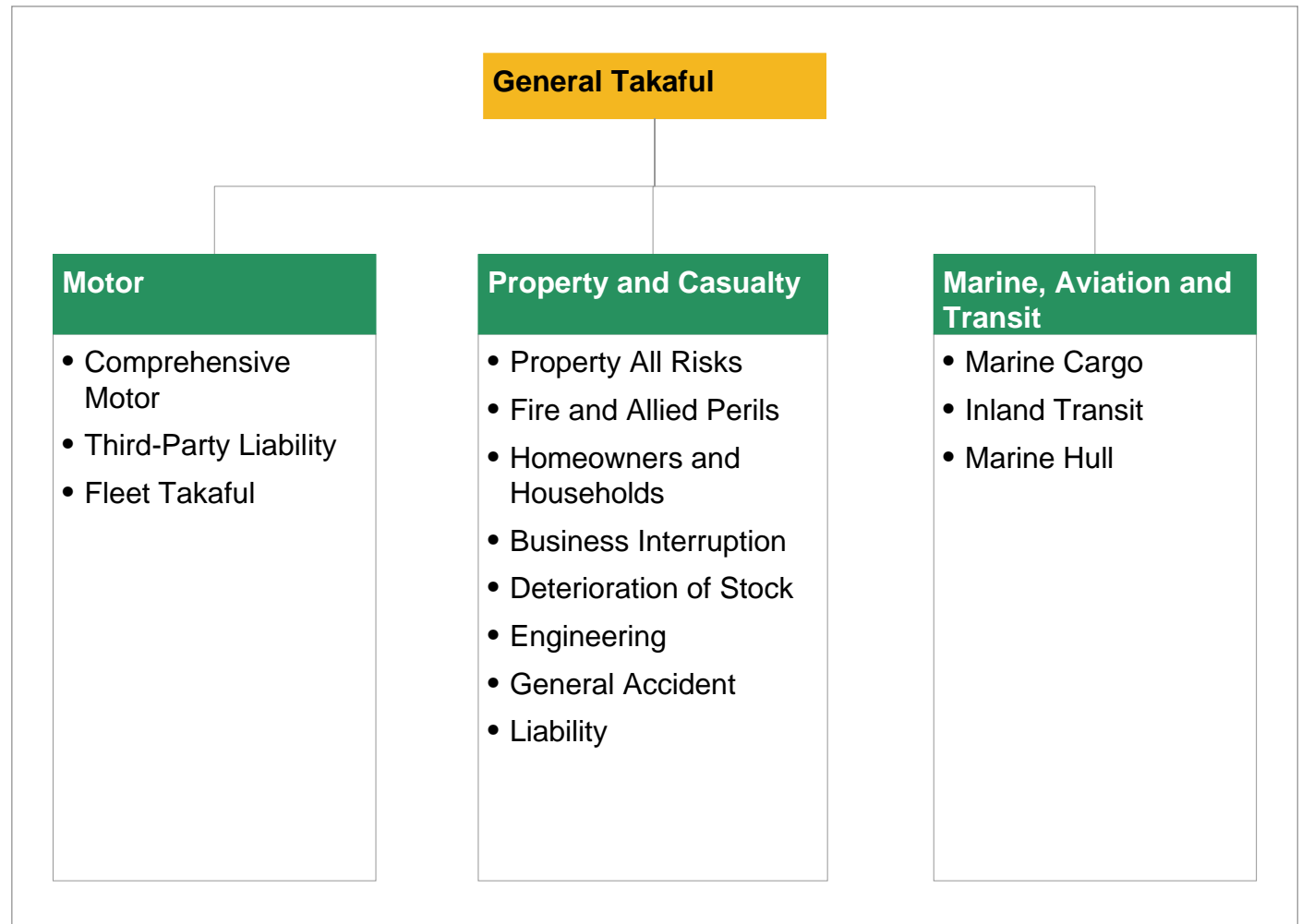
Global Gross Takaful Contributions in the GCC

Source Takaful Re Limited and Middle East Insurance Review (2008), E&Y Analysis, ICP

Section 4

Types of Islamic Insurance

Takaful Business Broadly Categorised as General and Family

General	• Protection against specific contingencies, e.g., fire, theft and accident
Family and Long-Term	• Insurance contract for payment of a stated amount of money to the beneficiary on the death or total or partial disability of the insured • Long-term savings plans to take care of investment needs of the client
Health	• Protection against loss by illness or bodily injury, providing coverage for medical treatment • Various practices are followed in the market for classification of health takaful, i.e., under general or family or independently

General Takaful

Motor Takaful

Key Considerations

- Visibility arm in the retail sector
- Risk assessment is relatively simpler
- Higher retention ratio

Comprehensive	Coverage against losses due to accident, fire, theft and policyholder's liability for personal injury or property damage to third parties arising from the use of the insured vehicle
Third-Party Liability	Indemnity against legal liability to third parties arising from the use of the insured vehicle in respect of death or bodily injury to third-party and damages to materials and property owned by third-party
Fleet Takaful	Covers all the vehicles belonging to an organisation in a single takaful certificate

Property and Casualty Takaful

Key Considerations

- Higher uncertainty in catastrophe risk profiles
- Higher exposures

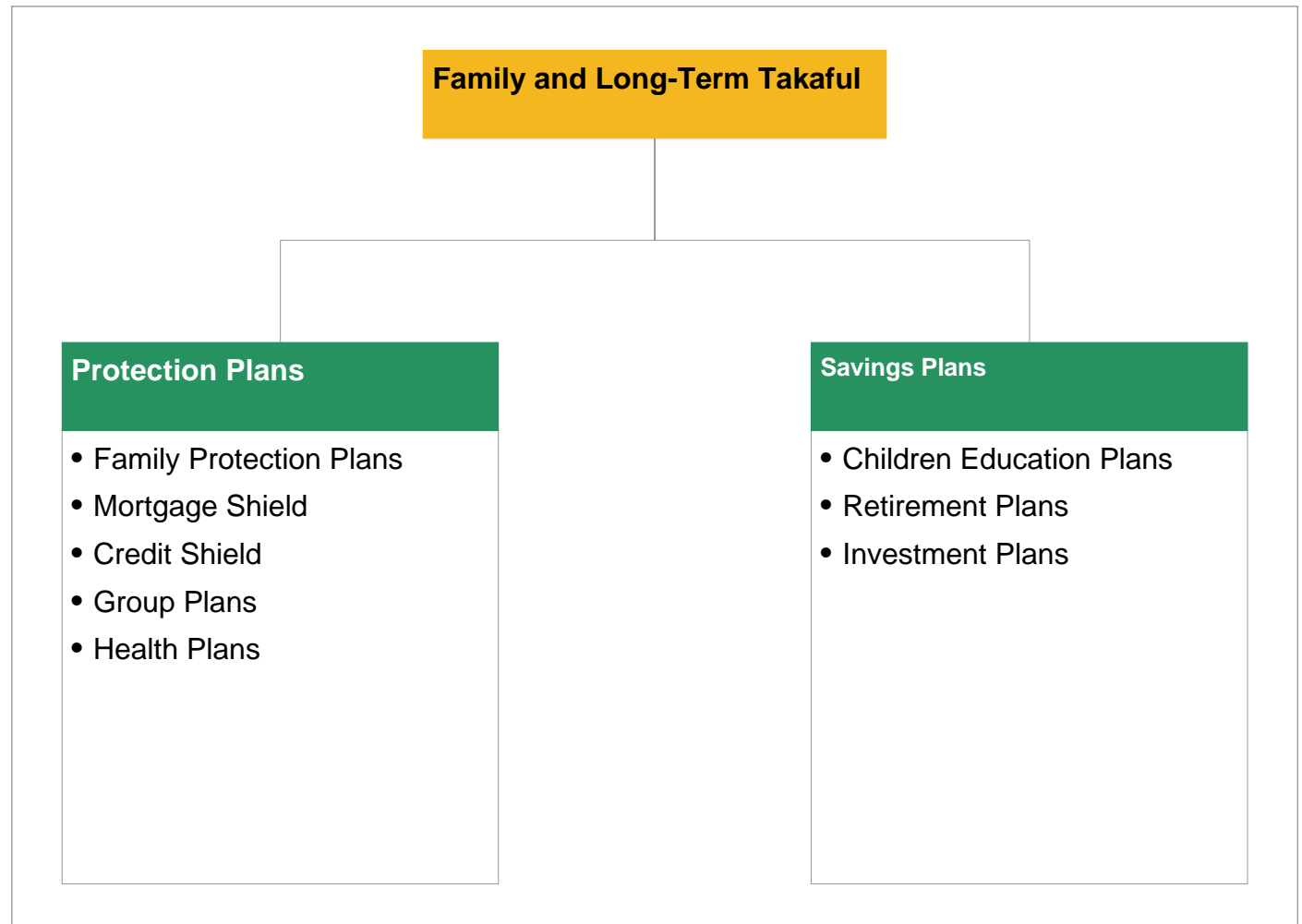
Property	• Coverage against losses and damages due to a wide range of causes such as fire, lightning, explosions, riots and burglary. Protection against damage to stock and business interruptions
General Accident	• Coverage against risks inherent in human society including plans such as money protection, fidelity guarantee, travel plan, burglary effects, event cancellation and personal accident (individual and group)
Liability	• Coverage against third-party liabilities including those towards employees including plans like general third-party liability, product liability, employers liability, workmen’s compensation, professional liability, ship repairers’ liability, airport operators’ and haulers’ liability

TYPES OF ISLAMIC INSURANCE

Marine, Aviation and Transit Takaful

Key Considerations

- Trade sensitive
- Complex risk assessment process

Family and Long-Term Takaful

Protection Plans

Individual Plans	Products offering protection against death and disability. Priced and underwritten generally in the name of a single person, although may have more than one life assured
Mortgage Shield	Product generally designed for financial institutions providing mortgage—outstanding loan balance paid from the plan in case of customer's death during term of the loan
Credit Shield	Cover to credit card holders by protecting the outstanding credit card balance in the event of an untimely death of a card holder
Group Plans	Single insurance policy that protects a specific group of people e.g., employees of a company, members of a professional organisation, or alumni of a college
Health Plans	Coverage for medicine, visits to clinics or emergency room, hospitalisation and other medical expenses—many options are offered with varied coverage

Savings Plans

Children Education Plan	Ensures that the child's education continues unhampered, in case of the unfortunate event of the death of a parent (life insured)
Retirement Plan	Ensures regular payments to the policyholder from retirement till death
Investment Plan	Generally a flexible policy that combines savings with life cover

Comparison of General and Family Takaful

Comparison of General and Family Takaful

Criteria	General	Family
Technical Knowledge	Higher	Lower
HR Intensive	Lower	Higher
Infrastructure	Lower	Higher (Health)
Regulatory	Jurisdiction Dependent	Jurisdiction Dependent
Competition	Jurisdiction Dependent	Jurisdiction Dependent
Gestation Period	Lower	Higher
Capital Intensive	Higher	Lower

Section 5

Key Regulatory and Legal Issues

Key Regulatory and Legal Issues

- New concept for regulators
- Financial reporting different from conventional insurance
- Separate disclosure for policyholders funds and shareholders funds
- Family takaful has no guarantees with no defined benefit whereas conventional insurance has defined benefits, thus requiring more regulatory supervision
- Different companies are following different policies in respect of distribution of surplus
- Asset profile of takaful companies will be different from conventional insurance companies due to prohibition of investing in interest-bearing instruments and certain types of equities

Section 6

Morgan Stanley Islamic Finance Window

- The Morgan Stanley Islamic Finance Window provides a full service offering
- The team has Sukuk structuring, and execution capabilities, as well as asset management and structured product structuring expertise
- Also a member of the Islamic Financial Experts Group advising the UK Government on their inaugural Sukuk issue and Islamic Finance strategy

Morgan Stanley Islamic Finance

Islamic Financing Transactions – Full Service Offering

Capital Market & Bank Financing Transactions (as Bookrunner/MLA)

- **First** international Islamic mandatory convertible for Tabreed
  - Upsized from initial AED1.1 Bn to AED1.7 Bn (AED1.5 Bn plus AED200 MM increase option)
- **First** true-sale securitization in the GCC region creating Islamic RMBS
  - Tamweel $220 MM mortgage backed security offering
  - **First** time tranching in a Sukuk product was allowed
  - Awarded **"Best Structured Deal 2007"** by Islamic Finance News
- **First** real estate project financing in the MENA region
  - Aldar $2.1 Bn syndicated credit facility

Fund Related Products

- Al-Futtaim MENA Real Estate Shari'a Development Fund. $500MM first closing in May '08. Sole Shari'a Structuring Advisor and Placement Agent
- $300MM Pearl Qatar Real Estate Development Fund. Closed in Jan '08 and was over subscribed. Sole Shari'a Structuring Advisor and Placement Agent
- Saudi Spanish Infrastructure Fund. $680MM first closing in December 2007. Sole Shari'a Structuring Advisor and Placement Agent

Structured Products

- A US$10 Bn structured notes programme has been established to issue a broad range of Islamic structured products
- Developed innovative Islamic short-medium term products for financial institutions that improve upon traditional commodity murabaha related instruments

Shari’a Supervisory Board

- The Morgan Stanley Shari’a Supervisory Board consists of world renowned scholars to ensure authenticity and Shari’a compliance of Morgan Stanley’s Islamic Finance business

Sheikh Nizam Yaquby, Bahrain

Considered one of the world’s leading experts in the field. He is a member of the Shari’a supervisory boards for several Islamic financial institutions, including Credit Suisse, Citi Islamic Investment Bank, Amanah Finance HSBC, Dow Jones Islamic Index, Abu Dhabi Islamic Bank, ABC Islamic Bank, Royal Bank of Canada, Shamil Bank and others.

Sheikh Yaquby was educated in the classical Shari’a sciences in his native Bahrain and in Makkah. He is a graduate in Economics and Comparative Religion from McGill University.

Dr Mohamed Elgari, Saudi Arabia

Former director of the Center for Research in Islamic Economics at King Abdulaziz University in Saudi Arabia, where he also serves as an Associate Professor of Islamic Economics. He is an expert at the Islamic Jurisprudence Academy, Jeddah. As well as a member of the Academic Committee at the Islamic Development Bank (IDB) and the Islamic Fiqh Academy in Jeddah. Dr. Elgari is a member of the Shari’a Boards of International Islamic Financial Market, Dow Jones Islamic Index, National Commercial Bank, Credit Suisse, Amanah Finance HSBC among others.

Dr Elgari holds a Ph.D. in economics from the University of California.

Dr Mohd Daud Bakar, Malaysia

Dr. Bakar is currently the President/CEO of the International Institute of Islamic Finance and Amanie Business Solutions Sdn. Bhd. He was an associate professor at the International Islamic University Malaysia. He is also Chairman of the Shari’a Advisory Council at the Central Bank of Malaysia, member of the Shari’a Advisory Council at the Securities Commission of Malaysia, Accounting and Auditing Organization for Islamic Financial Institutions and International Islamic Financial Market in Bahrain, Dow Jones Islamic Market Index as well as for various financial institutions. He is a licensed Shari’a advisor for Islamic Securities in Malaysia. In 2005 he was awarded the Islamic Banker Award by the Association of Islamic Banking Institutions Malaysia.

He received his first degree in Shari’a from University of Kuwait and PhD from the University of St. Andrews. In 2002, he completed his external Bachelor of Jurisprudence at University of Malaya.

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